Illustrating Participating
whole life insurance dividends

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What market conditions could cause the dividend scale interest rate to drop?

Dividend scales typically stay the same in the short term compared to other market indicators. But because of this, it makes it difficult to predict long-term returns of any investment. However, if interest rates remain low for an extended period of time dividend scale interest rates would likely follow, but at a slower rate of decline. For example:

Continued low interest rate scenario

- if long-term Government of Canada rates stayed around 3.0%,
- historical spreads and defaults remained constant,
- mortality and expense experience stay the same, and
- equity and real-estate markets yield average historical returns

Then par portfolio returns could gradually drop by 25 to 50 basis points within the next 10 years.

Alternate Scenarios

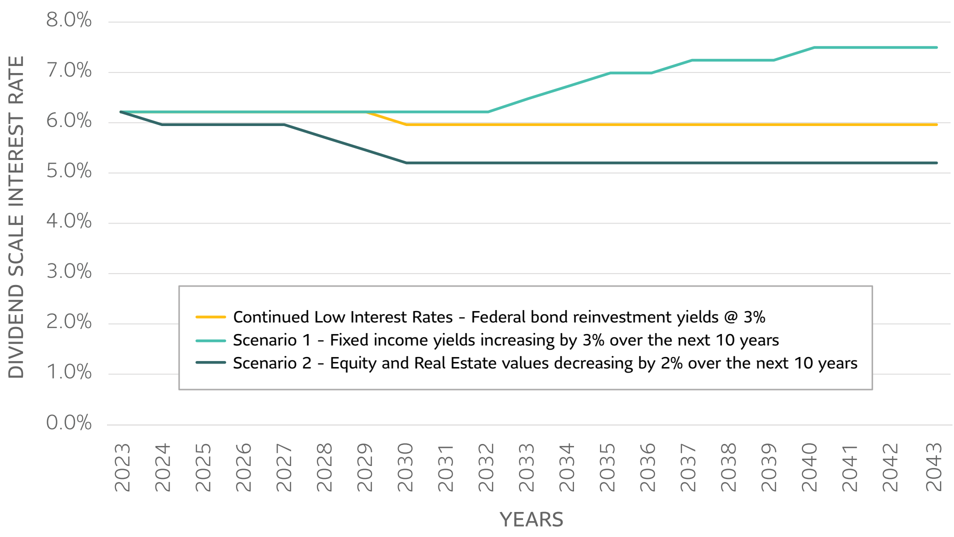
The alternate scenarios shown below illustrate positive and negative changes to equities, real estate returns and fixed income rates over the next 20 years. It shows the potential impact to a dividend scale interest rate over time.

Scenario one illustrates fixed income increasing from 3% to 6% gradually over the next 10 years.

Scenario two illustrates equities and real estate decreasing 2% gradually over the next 10 years and fixed income remaining constant.

For both scenarios expenses and mortality remain unchanged.

Possible dividend scale interest rate scenarios



Why does the dividend scale react to market changes?

Smoothing is the process of amortizing investment gains and losses over a number of years. The investment component of the dividend scale is smoothed by reflecting a portion of the current year's gains or losses and banking the remainder within the par account to be reflected over time.

The dividend scale is managed by Sun Life to pass through experience fairly, while mitigating fluctuations in the market. We look to current and anticipated future experience when determining the dividend scale and aim to minimize short-term volatility.

The result is a dividend scale interest rate that tends to fall more slowly than actual interest rates and equity markets. It also tends to increase more slowly when actual interest rates increase or equity markets enter periods of growth.

What are the components of the dividend scale?

There are a number of components that influence distributing policyholder dividends including investment returns, mortality, expenses, taxes, inflation and the number of policyholders that cancel their coverage.

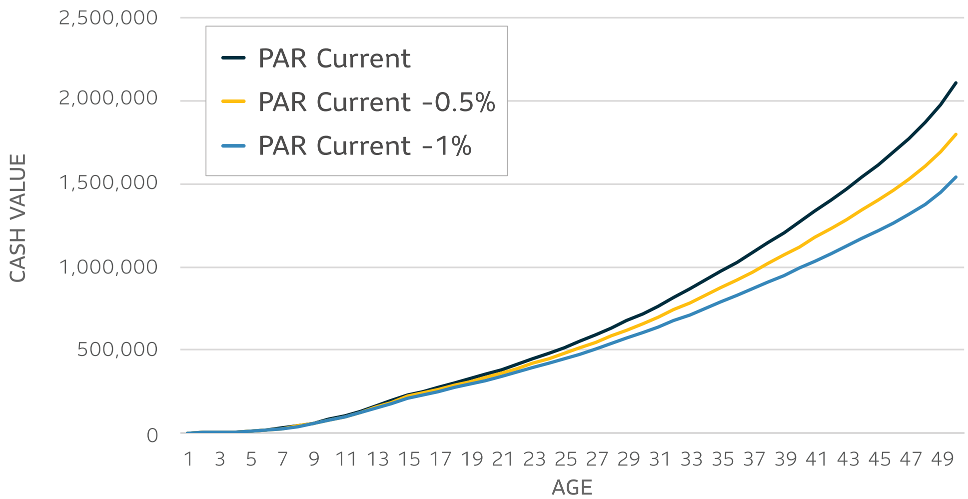
Typically, the three major components of the dividend scale are investment experience, mortality and expenses.

Investment experience – Interest: the interest component of the dividend is based on the performance of the investments within the participating account. The interest component tends to have the largest impact on the amount of dividends available to policyholders.

Mortality and expenses: generally, the mortality and expense experience have a similar positive impact on dividends available.

When dividends are used to purchase paid up additional insurance within a policy, a reduction in the dividend scale interest rate will result in lower cash value and death benefit growth than originally illustrated. It's important to illustrate alternate dividend scale scenarios so Clients can see how changes in the dividend scale interest rate affect their policy values. The impact of a dividend scale reduction on the cash values in a hypothetical policy are shown below.

Impact of alternate dividend scale interest rates*



*Based on male non-smoker, age 50, Sun Par Protector II, life pay, PUA dividend option, $500,000 face amount

Illustrating conservative values using the current dividend scale interest rate minus 0.5% and minus 1% will help Clients to understand the sensitivity of policy values to changes in the dividend scale interest rate. Running illustrations at -1% is not meant to represent a worst case scenario.

While it's impossible to predict market conditions over the short or long term or what will happen to the dividend scale interest rate, an illustration can help show sensitivities to the dividend scale interest rate. An illustration isn't predictive. The dividend scale is determined each year at the discretion of the board of directors.

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